Investment Outlook

A monthly round-up of
global markets and trends

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Investment outlook

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Brexit after Boris

Boris Johnson's resignation as Prime Minister on 7 July appears to have had little impact on UK financial asset prices. However, the long-term drag on the UK's stock market performance due to the country's relationship with the EU may begin to disappear.

To understand why, it is worth looking back at how UK stocks have fared since the recovery from the 2008/9 Global Financial Crisis. From then until the middle of 2014, the UK stock market performed similarly to the rest of the world. However, the emergence of the UK Independence Party (UKIP) under Nigel Farage contributed to the then Prime Minister David Cameron calling a referendum on the country's EU membership. The underperformance of the UK stock market, relative to the rest of the world, really started after UKIP won the biggest share of the popular vote in the May 2014 European Parliamentary election. Boris Johnson was a prominent Brexiteer and co-led the campaign to win the Brexit vote in June 2016.

Along with the uncertainty caused by the Brexit vote itself, British politics struggled in the aftermath leading to concerns in markets. The rise of Jeremy Corbyn with his hard-left agenda and plans to nationalise industries among other policies raised risks for businesses, while Theresa May's Government was politically paralysed as it tried to deliver Brexit. In addition to unfavourable politics, UK equities also struggled due to their heavy value-related bias to raw materials. This style underperformed significantly when compared to growth-centric technology stocks during this time. To put this into perspective, between 2014 and October 2020 the UK stock market underperformed global stock markets by more than 50%. However, today there are fewer political and market-related risks for internationally focused UK businesses from Brexit.

Although concerns remain over the Northern Ireland Protocol part of the Withdrawal Agreement, the UK did secure a quota and tariff-free trade relationship, on goods, with the EU in December 2020. Not only did this reduce the risk of a potential 'hard-Brexit' – where trade barriers could be introduced with the continent – it also brought greater investor clarity for the first time since the 2016 referendum.

Next, returns for UK investors have been boosted by weak sterling since the Brexit vote. As a result returns of foreign currency-denominated financial assets are worth more when they are converted back into sterling. Moreover, internationally focused UK companies can get a boost to their profits when overseas' earnings are repatriated back into sterling.

Finally, the UK's current account deficit with the EU has improved over the last six years narrowing to -3.5% of GDP from a record of -5.9% in the third quarter of 2016. It is difficult to disentangle the specific distortion effects from Brexit, Covid and rising fuel costs. However, much of the external deficit improvement can be traced back to reducing more expensive imports from the EU. The bottom line is the UK economy now appears less vulnerable to volatile international capital flows to fund its deficit.

Boris Johnson, one of the key orchestrators of Brexit, is expected to retire from front-line politics to the back benches. It is possible that a new prime minister could seek rapprochement with the EU, and tone down the hard Brexit ideology we have seen in recent years. For investors, Brexit risk has arguably come full circle to one of lesser importance for the future performance of the UK stock market. Since the deal with the EU on Christmas Eve 2020, the MSCI UK has outperformed the MSCI All Country World ex-UK equity benchmark by 10% in sterling terms. Much of this has been due to a strong performance in energy stocks. As such, much of the UK still trades at a hefty discount to its global peers and we believe there is plenty of room for the UK to outperform in a post-Brexit world.

Growing pains for the global economy

There was some respite in July for investors. Global stock markets rallied as the market began to forecast interest rates in the US would peak at a lower level before dropping sharply. Financial markets are forward looking and have started to factor in the effects of tighter monetary policy and the rising cost of living on households. Investors do still need to contend with slowing economic growth. For instance, the interest-rate sensitive US housing sector is heading south, while global manufacturers are seeing demand slowing as consumer spending habits change, switching to services over goods. These growth concerns are being priced into the market with lower bond yields and falling commodity prices. Concerns remain and risk-averse investors have helped to drive the US dollar to a 20-year high against major currencies.

Despite the recent rally, the sentiment remains gloomy across markets (and the media). However, we continue to believe there are reasons to be relatively upbeat on the resilience of the global economy. A survey of economists by Bloomberg revealed the consensus still expects 3.2% real GDP growth globally in both 2022 and 2023. This global growth outlook is supported by solid labour markets in developed economies and new financial stimulus in China. The expectations from the survey are that this stimulus could, by the middle of 2023, boost China's annual real GDP growth to 7% from 0.4% reported in the second quarter of 2022. Provided the global economy avoids a recession, companies can be expected to deliver on conservative Earning Per Share growth forecasts of 7% in 2023 to allow equities to recover from current oversold levels.

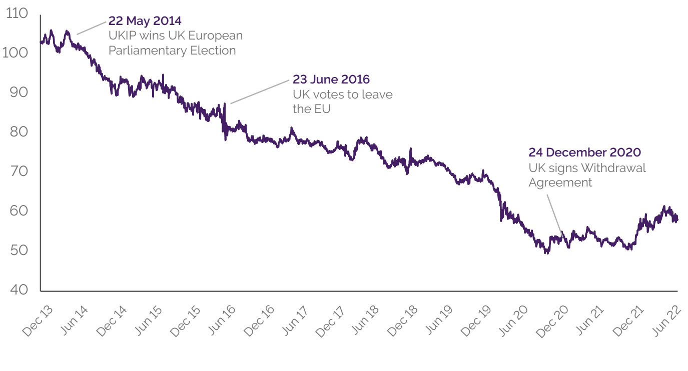
Sources:
Refinitiv/Evelyn Partners, as of 31 July 2022 (unless otherwise stated)

Market highlights

Equities

UK equities have underperformed their global peers for a long time. There are a variety of reasons for this, including little exposure to IT-related high growth companies, but the shadow of uncertainty over the country's relationship with its biggest trading partner, the European Union, is unlikely to have helped. Between 22 May 2014, when the UK Independence Party won the popular vote in the UK's European Parliamentary elections, and 24 December 2020, when the UK signed the Withdrawal Agreement, World ex-UK shares outperformed those in the UK by over 100% in sterling terms. Some closure to the uncertainty was bought with the Withdrawal Agreement at the end of 2020, although issues remain around the Northern Ireland Protocol. Since then, the UK equity market has begun to outperform as its exposure to energy and value sectors has benefitted from the global environment of rising interest rates.

MSCI UK relative perfomance to MSCI All Country World ex-UK in GBP TR terms (rebased)



Source: Refintiv Datastream/Evelyn Partners Investment Management LLP, data as at 31 July 2022

Fixed income

The pandemic shocked the global economy and meant yields on fixed income fell as investors fretted over the outlook for growth. Monetary and fiscal stimulus measures increased confidence and fuelled a recovery in yields, which have been broadly rising since. Since the 14 June, the yield on US 10-year government bonds has been falling as, once again, growth concerns are coming to the fore. Even as inflation continues to make headlines, reaching 40-year highs, markets are suggesting that interest rates will not move much higher in the face of economic uncertainty. Interest rate futures are indicating the Federal Reserve will have to begin cutting interest rates in 2023, far sooner than their own estimates. Despite economic concerns, a slowing in the pace of increasing interest rates is good news for both equity and bond markets, which have performed well over the last six weeks.

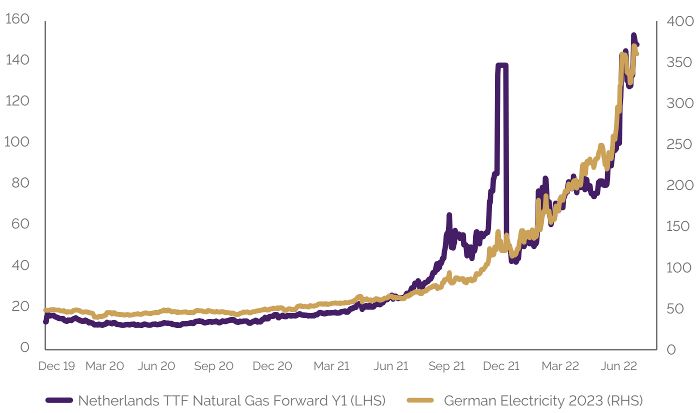
10 Year US Treasury Yield (%)

Source: Bloomberg/Evelyn Partners Investment Management LLP, data as at 31 July 2022

Currencies and commodities

As demand recovered following the pandemic lockdowns, European energy prices started to pick up. Russia's invasion of Ukraine and the subsequent sanctions on Russia have pushed prices even higher and increased volatility. In 2021, Russia supplied Europe with about 20% of its natural gas, most of which flowed through the Nord Stream 1 pipeline, which links Russia and Germany. In June flows through the pipeline were cut by 60% due to delays on a turbine being serviced. In July the pipeline then shutdown for its regular 10-day service period. After briefly reopening at the prior 40% capacity, it was announced there would be further reduction to 20% as another turbine needed maintenance. The EU have described the reductions as being politically motivated. Since the beginning of the pandemic (January 2020) Dutch gas prices have increased by over nine times, while the related price of German electricity has increased by over seven times.

European energy prices (EUR/Mwh)



Source: Bloomberg/Evelyn Partners Investment Management LLP, data as at 31 July 2022

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	6.8	1.3	2.7	62.1
MSCI UK	3.5	-0.5	12.8	22.7
MSCI UK Broad	4.3	-0.9	7.4	20.3
MSCI USA	9.1	3.2	6.4	97.5
MSCI Europe ex UK	5.2	-1.8	-6.5	28.0
MSCI Japan	5.5	2.1	-1.7	24.7
MSCI Pacific ex Japan	3.6	-2.2	2.6	27.0
MSCI Emerging Markets	-0.4	-3.3	-8.3	15.7
Bonds				
iBoxx GBP Gilts	2.8	-2.5	-14.3	-1.3
iBoxx USD Treasuries	1.5	4.0	4.1	14.2
iBoxx GBP Corporate	3.5	-1.5	-12.8	3.2
Commodities and trade-weighted FX				
Oil Brent Crude ($/barrel)	-4.2	2.1	43.9	109.7
Gold ($/ounce)	-2.4	-7.6	-3.2	39.0
GBP/USD	0.2	-3.1	-12.5	-7.7
GBP/EUR	2.7	0.3	1.8	6.7
EUR/USD	-2.5	-3.3	-14.0	-13.5
USD/JPY	-1.6	3.2	21.8	21.0

Market commentary

Companies and households continued to face a number of headwinds in July from rising inflation and slowing growth to growing political tensions. However, markets recovered from the lows seen in June and began to look through the negativity. US equities, which entered a bear market last month, led the way and bounced back delivering a 9.1% return, in sterling terms, for July. The UK ended the month in positive territory but up a more modest 3.5%. UK and US government bonds ended the month both delivering positive returns, 2.8% and 1.5% respectively, as the market expects future interest rates to peak at lower levels than previously anticipated. The oil price eased in July falling 4.2% although the focus was on natural gas. The price rocketed towards the end of the month as Russia cut supplies to Europe through the Nord Stream 1 pipeline.

Key macro data	Latest	2022 Consensus forecast	Spot rates	31-Jul	Yields (%)	31-Jul
UK GDP (YoY%)	8.70	3.40	GBP/USD	1.22	MSCI UK	3.80
UK CPI Inflation (YoY%)	9.40	8.60	GBP/Euro	1.19	MSCI UK broad	3.70
Bank of England Base	1.25	2.15	Euro/USD	1.02	10 Year Gilt	1.90

The market commentary, values and charts as at 31 July 2022. Total returns in sterling.
Returns are shown on a total return (TR) basis i.e. including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Refinitiv Datastream/Bloomberg

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